

BUMIPUTRA MERCHANT BANKERS BHD.

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v.

THE MELEWAR CORP. BHD. & ORS.

HIGH COURT MALAYA, KUALA LUMPUR

SITI NORMA YAAKOB J

[CIVIL SUIT NO. D2-23-3518-87]

17 JANUARY 1990

b

BANKING: *Guarantee - Syndicated term loan - Loan agreement - Same agent appointed for borrowers and lenders - Loan security documents included memorandum of deposit of shares - Security margin - Prescribed rate of interest - Sections 74 and 75 Contracts Act 1950 - Mortgagee's duty of care when exercising power of sale - Negligence.*

c

CONTRACT: *Imposition of interest rate - Clause in agreement overrides ss. 74, 75 of Contracts Act 1950.*

Under a loan agreement between a consortium of banks (the lenders) and the borrower, the three defendants had stood as guarantors. The plaintiff was appointed as the agent of the borrower as well as the lenders. The loan security documents comprised the loan agreement, the guarantee and a memorandum of deposit of 5.1 million shares (hereinafter referred to as the MAA shares).

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The borrower defaulted in servicing the interest payments and the plaintiff sold some of the MAA shares. However there was a shortfall and an O. 14 judgment was obtained by the plaintiff against the defendants. On appeal, the defendants raised various grounds of negligence, variation, prescribed rates of interest and duty of care.

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The issue was whether the lenders had been negligent in delaying the sales of the MAA shares once the entire loan had been recalled.

Held:

[1] A mortgagee has the right to choose the time to sell and when he has decided to sell, he owes a common law duty to the mortgagor to realise the true value of the property sold.

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[2] Taking into account the fact that the shares in question are public listed shares, the price of which is governed by the prevailing conditions of the market, the action of the mortgagees in selling the shares in stages was not considered to be negligent.

[3] Since none of the parties were certain of the effect of the charging order at the date on which it was served, the defendants cannot rely on the interpretation of the order as a triable issue.

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[4] On the evidence, the lenders did as much as they could once the borrower failed to comply with their requests.

[5] In relation to the imposition of interest at 2% per annum over the prescribed rate of default as being contrary to ss. 74 and 75 of the Contracts Act 1950; since this additional interest at 2% per annum was an agreed term which was incorporated into the loan agreement, the defendants cannot now raise any objection to the imposition of such a rate and therefore, ss. 74 and 75 of the Contracts Act do not apply.

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[6] On an interpretation of clause 10 of the guarantee, the lenders are at liberty to proceed against the defendants without resorting to the sale of the remaining shares still in their possession at the time of the filing of this action.

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- a** [7] Since the allegation of negligence against the lenders is unfounded, there is no basis on which the defendant's counter claim can stand and on that ground, the granting of a stay becomes redundant.

[Defendant's appeal and counter claim dismissed with costs.]

Cases referred to:

- b** *Farrar v. Farrar, Limited* [1889] 40 Ch D 395
Cuckmere Brick Co. v. Mutual Finance [1971] 2 All ER 63
Standard Chartered Bank Ltd. v. Walker & Anor. [1982] 3 All ER 938
Donoghue v. Stevenson [1932] AC 562

Legislation referred to:

Contracts Act 1950, ss. 74, 75

- c** *For the defendants/appellants - Teh Meng Teck; M/s. Cheah & Teh*
For the plaintiff/respondent - Tan Poh Meng; M/s. Nik Hussain & Partners

JUDGMENT

Siti Norma Yaakob J:

- d** The 3 defendants in this action are sued as guarantors pursuant to a guarantee dated 22 October 1985. They had guaranteed payment of all sums due and owing by Melewar Equities Sdn. Bhd. (the borrower), who is not a party to this action, to a consortium of banks (the lenders) under a loan agreement dated 22 October 1985 relating to a syndicated term loan of RM14 million.

- e** Under the loan agreement, the plaintiff was appointed the agent of the borrower as well as of the lenders and authorised to institute legal action against the borrower for any breach on the part of the borrower under the loan security documents, which in addition to the loan agreement and guarantee also include a memorandum of deposit of shares which was also executed on 22 October 1985. Under the memorandum, 1.7 million shares in Malaysian Assurance Alliance Bhd. (MAA shares) were originally charged to the lenders but following the exercise of a bonus and rights issue, the number of MAA shares pledged increased to 5.1 million.

- f** The borrower defaulted in servicing the interests due as early as 28 August 1986 and following this, the plaintiff sold 3,339,100 MAA shares between 20 March 1987 to 22 July 1987, but the proceeds of sale were not sufficient to cover all the sums due from the borrower as a result of which the present action was filed against the defendant guarantors to meet the shortfall.

- g** In this instant appeal against O. 14 summary judgment obtained by the plaintiff against them, the defendants raised the following issues:

1. The lenders had been negligent in not taking steps to ensure that the borrower maintain the security margin of the MAA shares.
- h** 2. By not insisting on the security margin, the lenders had varied the terms of the loan agreement with the borrower to the detriment of the defendants.
3. The plaintiff has claimed penalty interest of 2% per annum over and above the prescribed rate after default, in contravention of ss. 74 and 75 of the Contracts Act 1950.

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4. The claim against the defendants is premature as at the time of the filing of this suit the lenders were still in possession of 1,760,900 MAA shares which they should have sold first so as to reduce the amount owed to them, thereby reducing the defendants' liability to meet payment. a
5. In the event the appeal is dismissed, execution of the judgment should be stayed pending the determination of the defendants' counter claim and the disposal of the remaining MAA shares still in the possession of the lenders. b

Under s. 5.01 of the loan agreement, the aggregate market value of the MAA shares shall be maintained by the borrower at all times at not less than 1.67 times over and above the amount outstanding to the lenders. Following the borrower's default in August 1986, the lenders recalled the entire loan through their letter dated 24 March 1987.

The defendants now contend that had the plaintiff been diligent in selling all the 5.1 million MAA shares immediately after sending the letter of demand, when the price of MAA shares was traded at RM3.80 per share at the Kuala Lumpur Stock Exchange, the plaintiff would have realised RM19,380,000 which was more than sufficient to meet the borrower's liability which at that time amounted to RM15,817,891.78, thus rendering the filing of this action unnecessary. As the lenders had failed to do so, the defendants maintain that the lenders had breached the duty of care they owed the defendants as mortgagees of the MAA shares. c
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It is not disputed that the lenders started to sell the MAA shares from 20 May 1987 until 5 June 1987, when they stopped but continued selling again from 3 July 1987 until 22 July 1987, by which time they had sold 3,339,100 units at prices varying from RM3.70 per share at the highest to RM3.20 per share at the lowest. It was following the last sale transacted on 22 July 1987 that the present suit was filed on 27 October 1987, claiming the shortfall in the loan still due and owing after credit had been given from the proceeds of the sales. I also need to state here that since the filing of this suit, the lenders have sold a further 431,000 MAA shares thereby reducing the principal amount originally claimed from RM4,775,456.85 to RM4,630,034.78. e

What is in issue here is whether the lenders had been negligent in delaying the sales of the MAA shares once the entire loan had been recalled in March 1987. To determine this I have to consider what is the duty of care that is owed by a mortgagee when exercising his power of sale. In *Farrar v. Farrar, Limited* [1889] 40 Ch D 395, it was held that: f

a mortgagee exercising a power of sale is not a trustee of the power. The power arises by contract with the mortgagor and forms part of the mortgagee's security. He is bound to sell fairly and to take reasonable steps to obtain a proper price, but he may proceed to a forced sale for the purpose of paying the mortgaged debt... The mortgagor has no right after the power has arisen to insist that the mortgagee shall wait for better times before selling. This observation applies in full force where the mortgaged property is of a speculative character, and is not producing any income. The mortgagee has a right to obtain payment of his debt through the exercise of his power when it has arisen without regard to the then existing condition of the market. He cannot be required to run any risk in postponing the sale, or to speculate for the mortgagor's benefit. g
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The same pronouncements of law were affirmed by Salmon LJ in the later case of *Cuckmere Brick Co. v. Mutual Finance* [1971] 2 All ER 63 when he held that:

it is well settled that a mortgagee is not a trustee of the power of sale for the mortgagor. Once the power has accrued, the mortgagee is entitled to exercise it for his own purpose whenever he choses to do so. It matters not that the moment may be unpropitious and that i

- a** by waiting a higher price would be obtained. He has the right to realise his security by turning it into money when he likes. Nor, in my view, is there anything to prevent a mortgagee from accepting the best bid he can get at an auction, even though the auction is badly attended and the binding exceptionally low. Provided none of these adverse factors is due to any fault of the mortgagee, he can do as he likes. If the mortgagee's interests, as he sees them, conflict with those of the mortgagor, the mortgagee can give preference to his own interests, which of course he could not do were he a trustee of the power of sale for the mortgagor.
- b** From these 2 cases, it is clear that a mortgagee has the right to choose the time to sell and when he has decided to sell, he owes a common law duty to the mortgagor to realise the true value of the property sold. This duty has been described by Lord Denning MR in the case of *Standard Chartered Bank Ltd. v. Walker & Anor.* [1982] 3 All ER 938:
- c** as only a particular application of the general duty of care to your neighbour which was stated by Lord Atkin in *Donoghue v. Stevenson* [1932] AC 562 and applied in many cases since... The mortgagor and the guarantor are clearly in very close 'proximity' to those who conduct the sale. The duty of care is owing to them, if not to the general body of creditors of the mortgagor. There are several dicta to the effect that the mortgagee can choose his own time for the sale, but I do not think this means that that he can sell at the worst possible time. It is at least arguable that, in choosing the time, he must exercise a reasonable degree of care.
- d** The mortgagees in *Cuckmere Brick's* case were held to be negligent when they admitted omitting to disclose material facts in the advertisement of a public auction which would have drawn more interests from the public and the sale would have fetched a higher price. Likewise, the *Standard Chartered Bank* case, the Court held that the sale was negligently conducted as the bank had directed the receiver to conduct the sale with haste.
- e** It must be remembered that the MAA shares are public listed shares, the price of which is strictly governed by the prevailing conditions of the market. The plaintiff had sold the shares at the stock market at prices regulated by the market. As prices of shares in the stock market are highly speculative, I consider that it is most unreasonable to expect the plaintiff to watch the market closely and to sell only at one given time when the prices are high. Even a broker,
- f** who is in the know, cannot tell when shares can be traded at their highest or lowest price. There is also the apparent danger that a large bulk of shares sold at one given point of time, may have a negative effect as this may force the price of the shares to dip. It was to avoid this unhappy situation that the lenders took the precaution of selling the MAA shares in stages and I do not consider that such action to be in any way negligent of the lenders when they were exercising their power of sale.
- g** The plaintiff has also explained that the lenders stopped selling after 5 June 1987, as the lenders were served with a charging order dated 28 May 1987, by Noone & Co. Sdn. Bhd. (Noone), who had obtained a default judgment against the borrower in a separate and unrelated civil suit. The effect of the charging order was to freeze all the borrower's shareholdings in Malaysian Assurance Alliance Bhd. (MAA) and this in turn includes the MAA shares that had been pledged to the lenders. The lenders were served with the charging
- h** order on 8 June 1987 and the plaintiff successfully applied to intervene in proceedings between Noone and the borrower and on 1 July 1987, the plaintiff obtained an order to vary the charging order so as to exclude the MAA shares already pledged to the lenders.
- On 3 July 1987, the plaintiff recommenced selling the balance of the MAA shares but discontinued doing so after 22 July 1987 when the lenders were served with the following
- i** summonses.

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| 1) A notice of appeal to a Judge in chambers by Noone, who were dissatisfied with the order to vary the charging order granted on 1 July 1987. | a |
| 2) An application also by Noone to stay the variation order obtained on 1 July 1987 until after the appeal was heard and determined. | |

On 6 August 1987, Noone was granted a stay pending the appeal and on 25 February 1989, Noone's appeal was dismissed with costs. In between the period when the stay was granted and the appeal determined came the Stock Exchange crash in October 1987 which effected the stock markets throughout the world and sent prices of shares tumbling down.	b
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It is the defendants' contention that the charging order does not effect the pledged MAA shares as the order was only intended to freeze only those shares that the borrower was entitled to beneficially either directly or indirectly through their nominees. In the case of the pledged MAA shares since they have already been transferred and registered into the names of the lenders' nominees, the charging order does not effect the pledged MAA shares and as such there was no reason for the plaintiff to postpone the sale of the shares on the ground of the presence of the charging orders.	c
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If indeed the lenders were mistaken as to which shares the charging order refers to, the borrower's conduct in proceedings leading to the revocation of the charging order and its subsequent conduct in getting the charging order discharged all point to the fact that the borrower too must have been mistaken as to the intention of the charging order. It is all well and good that on hindsight the defendants can now give a clear interpretation as to the charging order but at the time of the service of the order on the lenders, the borrower and for that matter the defendants were no more the wiser as to the extent of the charging order. The lenders had to give a reasonable interpretation to the order and since it relates to 60% of shares held by the borrower in MAA which also includes the MAA shares which had already been charged to the lenders, the so called mistaken interpretation of the charging order cannot now be relied on by the defendants and cannot be averred as a triable issue.	d e
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As for the defendants' averment that the plaintiff had not insisted that the borrower top up the security margin leading to the variation of the terms of the loan agreement, I do not consider that there is any merit to this submission. There is ample documentary evidence to show that after the borrower's default, there were meetings held and letters written to the borrower requesting the borrower to top up the security margin or alternately reduce loan outstanding. Minutes of two meetings held on 28 August 1986 and 31 December 1986 and the plaintiff's letter dated 1 October 1986 all testify to this fact. As far as I can see, there is nothing more the lenders can do if the borrower fail to comply with such requests and to that extent it is not for the defendants to state that the plaintiff had done nothing to insist upon the borrower to top up the security margin. To that end there is no question as to the terms of the loan agreement being varied by anybody.	f g
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The defendants also object to the imposition of interest at 2% per annum over the prescribed rate after default as being contrary to ss. 74 and 75 of the Contracts Act 1950. It is their contention that as this is a form of special damages, the plaintiff must prove such damages. Again I do not see any merit to this objection as under s. 4.08 of the loan agreement, additional interest at 2% per annum shall be paid by the borrower on all sums over and above the prescribed rate of interest as specified by s. 4.04 by way of agreed damages. As this is an agreed term of the loan agreement, the defendants cannot now raise any objection to the imposition of such a rate and to that end, ss. 74 and 75 of the Contracts Act do not apply.	 h i
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a There was still a balance of the MAA shares yet unsold in the hands of the lenders at the time this action was filed and it is the defendants' contention that such shares should be sold first before they can be sued. The answer to this objection lies in clause 10 of the guarantee which states as follows:

b 10. The lenders shall be at liberty but not bound to resort for the lenders' own benefit to any other means of payment at any time and in any order that the lenders think fit without thereby diminishing the respective liabilities of the guarantors and the lenders may put this guarantee in force either for the payment of the ultimate balance after resorting to other means of payment or for the balance due at any time notwithstanding that other means of payment have not been resorted to and in the latter case without entitling the guarantors to any benefit from such other means of payment so long as any monies remain due from the principal to the lenders.

c Under the wide provision of this clause, the lenders are at liberty to proceed against the defendants without resorting to the sale of the remaining shares still in their possession at the time of the filing of this action. These shares have since been sold and credit given.

d The defendants have also filed a counter claim founded on the lenders' alleged negligence in delaying selling off the shares upon the borrower's default. Relying on their counter claim they now aver that in the event their appeal is dismissed, execution of the judgment be stayed pending the hearing and determination of their counter claim.

As I have already ruled that the allegation of negligence against the lenders is unfounded, there is therefore no basis on which the counter claim can stand and on that ground, the granting of a stay becomes redundant.

e For the above reasons, I had dismissed the defendants' appeal with costs and I had also ordered that the defendants' counter claim be struck out with costs.

Also found at [1990] 2 CLJ 30

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